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State of South Carolina  
**Department of Revenue**  
301 Gervais Street, P. O. Box 125, Columbia, South Carolina 29214

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SC INFORMATION LETTER #96-15

**SUBJECT:** ADMINISTRATIVE PRONOUNCEMENT  
Proposed Rules on Entity Classification  
(Income Tax)

**DATE:** June 12, 1996

**SUPERSEDES:** All previous documents and any oral directives in conflict herewith.

**AUTHORITY:** S.C. Code Ann. Section 12-4-320 (Supp. 1995)  
SC Revenue Procedure #94-1

**SCOPE:** An Information Letter is a document issued for the purpose of disseminating general information or information concerning an administrative pronouncement.

Information Letters issued to disseminate general information have no precedential value and do not represent the official position of the Department. Information Letters designated as administrative pronouncements are official advisory opinions of the Department.

On May 9, 1996, the Internal Revenue Service issued proposed regulations for determining the classification of an unincorporated business organization as either a partnership or a corporation for federal income tax purposes. These regulations will replace the existing four characteristic test of (1) continuity of life, (2) centralized management, (3) limited liability, and (4) free transferability of interests to allow an unincorporated entity to elect its classification for federal tax purposes. This new classification process is referred to as "check the box."

These proposed regulations will generally apply to domestic and foreign unincorporated entities, such as limited liability companies, including single member limited liability companies. More specifically, these regulations will permit a limited liability company a choice to be taxed as a partnership (a sole proprietorship for a one member entity) or as a corporation.

The proposed regulations also include rules for default classification. The default rules provide most eligible entities with the classification they would choose without requiring an election to be filed. An eligible entity that does not want the classification provided by the default provision, or wants to change its classification, may file an election to obtain the chosen classification. Further, under the new rules, existing entities that want to retain their current classification would not be required to file an election.

The proposed federal regulations revise Treasury Regulation sections 301.7701-1 through 301.7701-3 to clarify which organizations are classified as corporations automatically under the Internal Revenue Code. Also, the proposed regulations have conforming changes to Treasury Regulation sections 1.581-1, 1.581.2, and 1.761-1 and to sections 301.6109-1, 301.7701-4, and 301.7701-7.

A copy of the proposed regulations is attached.

The Department of Revenue applauds the proposed entity classification rules. For South Carolina income tax purposes, the Department intends to follow them as soon as they are effective for federal income tax purposes. The proposed regulations state that they are effective for periods beginning on or after the date the final regulations are published. An IRS official stated at a recent meeting of the Tax Section of the American Bar Association that the proposed rules should be final by the end of the year.